INTERNAL REVENUE SERVICE
NATIONAL OFFICE TECHNICAL ADVICE MEMORANDUM

Index (UIL) No.: 56.15-00
CASE MIS No.: TAM-116141-98

DEC - 8 1998

Taxpayer's Name:

Taxpayer's Address:

Taxpayer's Identification No:

Years Involved:

Date of Conference:

ISSUE: In the case of a taxpayer with mining property placed in service in a taxable year beginning before January 1, 1990, does the taxpayer have an adjustment under section 56(g)(4)(C)(i) of the Internal Revenue Code in computing adjusted current earnings if, in computing pre-adjustment alternative minimum taxable income, the taxpayer deducts an amount under section 611(a) that is in excess of the adjusted basis of the mining property for cost depletion purposes?

CONCLUSION: If mining property is placed in service in a taxable year beginning before January 1, 1990, the taxpayer has an adjustment under section 56(g)(4)(C)(i) of the Internal Revenue Code in computing adjusted current earnings if the taxpayer deducts an amount under section 611(a) in computing pre-adjustment alternative minimum taxable income that is in excess of the adjusted basis of the mining property for cost depletion purposes.

FACTS:

Taxpayer is a corporation engaged in the business of mining . The mines

that are the subject of this technical advice memorandum (TAM) were placed in service before January 1, 1990. For the tax years involved in this TAM, Taxpayer's adjusted basis for cost depletion purposes, as determined under section 612 and the regulations thereunder, was zero. Accordingly, Taxpayer used percentage depletion in computing its allowable deduction under section 611(a).

In the tax years involved, Taxpayer incurred mining development costs, and for regular tax purposes, deducted those costs under section 616(a). In accordance with section 291(b), Taxpayer was required to reduce its section 616(a) deduction by 30 percent and amortize that 30 percent amount over 60 months.

For alternative minimum tax purposes, Taxpayer, under section 56(a)(2), capitalized the section 616(a) development costs and will amortize those costs over a period of ten years. In each of the tax years involved, for purposes of calculating its section 57(a)(1) depletion preference, Taxpayer included in the adjusted basis of the mining property the development costs incurred in the year but capitalized under section 56(a)(2) .

Taxpayer, in computing pre-adjustment alternative minimum taxable income (AMTI) in each of the years involved, was required to reduce the amount of its section 611(a) deduction by the section 57(a)(1) depletion preference. However, because the capitalized development costs were included in the adjusted basis of the mining property for purposes of computing the section 57(a)(1) depletion preference, Taxpayer's depletion preference did not completely offset its section 611(a) deduction. Thus, in computing pre-adjustment AMTI, Taxpayer was entitled to deduct an amount under section 611(a) even though Taxpayer's adjusted basis for cost depletion purposes was zero in those years. The IRS revenue agent therefore contends that since Taxpayer's pre-adjustment AMTI includes a deduction under section 611(a) that is in excess of the section 611(a) amount allowable in computing earnings and profits, Taxpayer has an adjustment under section 56(g)(4)(C)(i) in computing adjusted current earnings (ACE).

LAW AND ANALYSIS:

Section 55 of the Code imposes, in addition to the other taxes imposed by subtitle A, an alternative minimum tax (AMT) equal to the excess (if any) of the tentative minimum tax (TMT) for the taxable year, over the regular tax for the taxable year. The TMT equals the AMT rate applied to the excess of AMTI for the taxable year over an exemption amount, reduced by the AMT foreign tax credit for the taxable year.

Section 55(b)(2) of the Code defines AMTI as the taxable income of the taxpayer for the taxable year, determined with the adjustments provided in section 56 and 58, and increased by the items of tax preference provided in section 57.

Section 56(g)(1) requires corporations to take into account in computing AMTI an ACE adjustment. The ACE adjustment is equal to 75 percent of the difference between the corporation's adjusted current earnings (ACE) and its pre-adjustment AMTI (AMTI determined without regard to the ACE adjustment and the AMT net operating loss deduction). Under section 56(g)(3), ACE is equal to AMTI for the year, determined with the adjustments provided in section 56(g)(4), and without regard to the ACE adjustment and the AMT net operating loss deduction.

Section 56(g)(4)(C)(i) provides that, in computing ACE, a deduction is not allowed for any item that is not deductible for any taxable year for purposes of computing the corporation's earnings and profits.

Section 1.312-6(c)(1) of the Income Tax Regulations provides that in the case of a corporation in which depletion or depreciation is a factor in the determination of income, the only depletion or depreciation deductions to be considered in the computation of the total earnings and profits are those based on cost or other basis without regard to the March 1, 1913, value. In computing earnings and profits for any period beginning after February 28, 1913, the only depletion or depreciation deductions that are to be considered are those based upon (1) cost or other basis, if the depletable or depreciable asset was acquired after February 28, 1913, or (2) adjusted cost or March 1, 1913, value, whichever is higher, if acquired before March 1, 1913. Discovery or percentage depletion under all revenue acts for mines and oil and gas wells is not to be taken into consideration in computing the earnings and profits of a corporation. Thus, under section 1.312-6(c)(1), only depletion deductions based upon cost depletion are deductible in computing earnings and profits.

In the present case, Taxpayer's adjusted basis in the mining property for purposes of cost depletion was zero. Consequently, Taxpayer's section 611(a) deduction for purposes of computing earnings and profits was zero. Taxpayer's pre-adjustment AMTI includes amounts deducted under section 611(a). Accordingly, in accordance with section 56(g)(4)(C)(i), Taxpayer must increase its ACE by the amount of the section 611(a) deductions included in pre-adjustment AMTI.

Taxpayer's position is that section 56(g)(4)(C)(i) is not applicable. First, Taxpayer contends section 56(g)(4)(C)(i) is not applicable because the section 616 deferred development costs, which the revenue agent argues are the cause of the proposed ACE adjustment, are deductible for purposes of computing earnings and profits and therefore cannot cause an ACE adjustment. Under section 312(n)(2)(B),

section 616 costs are capitalized and amortized over a 120-month period in computing earnings and profits. Thus, Taxpayer argues, because the section 616 costs are eventually deductible in computing earnings and profits, those costs do not create a permanent difference between ACE and pre-adjustment AMTI nor, therefore, an adjustment under section 56(g)(4)(C)(i).

While we agree that section 616 costs are deductible for earnings and profits purposes and will not cause an ACE adjustment under section 56(g)(4)(C)(i), it is Taxpayer's section 611(a) depletion deduction that causes the adjustment under section 56(g)(4)(C)(i). In the present case, the amount Taxpayer deducted for depletion under section 611(a) in computing pre-adjustment AMTI equals the development costs incurred but deferred in the taxable year and thus included in adjusted basis. Taxpayer's section 611 depletion deduction, however, is separate from, and in addition to, any section 616 deduction for development costs. As previously noted, because Taxpayer's section 612 adjusted basis for cost depletion purposes was zero, the amount deducted under section 611(a) in computing pre-adjustment AMTI results in an adjustment under section 56(g)(4)(C)(i) since, in computing earnings and profits, only amounts deductible for cost depletion are allowed under section 611(a).

Secondly, Taxpayer argues that because there is an ACE adjustment specifically for percentage depletion (section 56(g)(4)(F)) and the adjustment applies only for property placed in service after December 31, 1989, Congress intended that there be no ACE depletion adjustment for mining property placed in service before January 1, 1990. While we concede that section 56(g)(4)(F) applies only where mining property is placed in service after December 31, 1989, there is nothing in section 56 or its legislative history that suggests that section 56(g)(4)(C)(i) is not applicable to the present case. First, section 56(g)(4)(C)(i) includes no exception for depletion in the case of property placed in service before January 1, 1990. Thus, the literal language of section 56(g)(4)(C)(i) applies in the present case since the amount Taxpayer deducted under section 611(a) for pre-adjustment AMTI purposes clearly exceeds the amount deductible under section 611(a) for purposes of computing its earnings and profits. Further, when Congress amended section 56(g)(4)(F) to remove the ACE depletion adjustment for independent oil and gas producers and royalty owners, it provided that both section 56(g)(4)(F) and section 56(g)(4)(C)(i) shall not apply to any depletion deductions. Apparently, therefore, Congress believed that, for purposes of computing ACE, section 56(g)(4)(C)(i) could also operate to disallow depletion deductions in excess of cost depletion. Accordingly, it is our position that for property placed in service before January 1, 1990, section 56(g)(4)(C)(i) applies when a taxpayer, in computing pre-adjustment AMTI, deducts an amount under section 611(a) that exceeds the adjusted basis of the mining property for cost depletion purposes.

CAVEAT(S)

A copy of this technical advice memorandum is to be given to the taxpayer(s). Section 6110(j)(3) of the Code provides that it may not be used or cited as precedent.